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**A REPORT BY THE SECOND TIER COMMITTEE ON
POLICIES TO IMPROVE CANADIAN COMPETITIVENESS**

OCTOBER 1978

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THE SECOND TIER COMMITTEE ON

POLICIES TO IMPROVE CANADIAN COMPETITIVENESS



October 1978

The Prime Minister and Premiers of Canada agreed last February "to seek out the active involvement of the private sector (including business and labour) in federal-provincial discussions on specific development programs tailored to the particular requirements of each of the manufacturing sectors".

At their request, 23 industry consultative Task forces were established to make recommendations to the provincial and federal governments. These sector Task forces were composed of representatives from business, labour and academia. The provincial and federal governments were involved as observers or participants.

The reports of the Task forces have been submitted to Canadian governments. They also have been reviewed by the "Second Tier Committee" whose mandate was expressed to them by federal Industry, Trade and Commerce Minister Jack Horner:

"Your mandate is to work directly from the Task force reports and attachments to identify and make recommendations about factors and policies that cut across sector lines. You will pull together the common threads running through the reports to make recommendations on broad economic policy and on issues important generally to manufacturing and tourism. You will, if you wish, make recommendations as well on major sector-specific issues."



SECOND TIER COMMITTEE MEMBERS

Chairman: Ralph Barford, Chairman, G.S.W. Ltd./Ltee, Toronto

Robert Needham, Associate Professor of Economics, University of Waterloo

Canadian Labour Congress:

Shirley G.E. Carr, Executive Vice-President, Canadian Labour Congress, Ottawa

Gerard Docquier, National Director, United Steelworkers of America, Toronto

Sam Fox, Director, Clothing Division, Amalgamated Clothing and Textile Workers Union, Toronto

Ken Rose, International Vice-President, International Brotherhood of Electrical Workers, Willowdale

Mike Rygus, General Vice-President, International Association of Machinists and Aerospace Workers, Ottawa

Business Representatives:

Ian A. Barclay, Chairman, B.C. Forest Products Ltd., Vancouver

Laurent Beaudoin, Chairman, Bombardier Inc., Montreal

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PART I INTRODUCTION

This industry consultative process was initiated by Canada's First Ministers at their meeting in February 1978, as a result of concerns expressed regarding the performance of Canada's manufacturing industries. First Ministers requested business and labour in 23 selected industrial sectors to prepare reports on what actions government and the private sector might take to improve the productivity and competitiveness of these industries.

The individual sectoral Task forces began their interesting and lively meetings in early March 1978. Their reports were completed by the end of July 1978. This was an achievement involving nearly 500 Canadians, most of whom work in manufacturing or closely related industries.

At the end of July, the Second Tier Committee was convened. The task of the Tier II Committee was to produce this report based on the material found in the 23 individual sector Task force reports.

The preparation of the 23 individual Task force reports, along with this report, is the first such major, national joint effort by business and labour in Canada's history. The results of this significant effort must be considered a starting point for action; clearly it is not an industrial strategy for Canada. It does identify many areas where agreement was reached and where recommendations can be made jointly by labour and business.

Possibly its most important contribution is the process itself. This is the first time business and labour, under government auspices, have jointly worked on major economic problems and come up with specific recommendations.

Business and labour found more issues on which they could agree than at first thought possible.

Both business and labour recognize the vital importance of manufacturing as the engine of growth in creating jobs and enhancing standards of living. Both agree they have important and legitimate roles to play in proposing policies and actions to government affecting the industrial environment.

Both labour and business members of the Committee recognize the fundamental democratic responsibilities of elected governments to govern. The Committee, in putting forward recommendations for government action, does not seek to share this responsibility; governments must be responsible

and must clearly be seen to be responsible for the decisions they take. The Committee does believe, however, that labour and business should be more actively involved in the process prior to decisions being made.

Finally, we would like to emphasize that our Committee was composed of 12 concerned citizens, eight of whom participated in the sector Task forces.

An independent Chairman was selected by mutual agreement. One member is a professor of economics.

The five labour representatives are members of the Executive Council of the Canadian Labour Congress (CLC) and acted in that capacity. One is executive vice-president of the CLC. The other four are the senior executive officers of their unions.

The five business members are chief executive officers who manage reasonably large domestic or foreign-owned Canadian corporations; extractive and service industries and small business were not directly represented.

The staff support for this Committee has consisted of one business and one labour member with a neutral staff member appointed through the Institute for Research on Public Policy in Montreal, Quebec. In addition, the Committee sought outside expertise as appropriate.

The Importance of Manufacturing Industries in Canada

The strengthening of the manufacturing sector is closely related to the attainment of a number of Canada's social and economic objectives. Of fundamental importance, in both a social and economic sense, is the relationship that exists between an expanded manufacturing sector and the attainment of full employment in Canada. Moreover, the development of a stronger and more diversified manufacturing sector can also contribute in an important way to reductions in regional disparities, to improvements in the balance of international payments and to increases in standards of living.

Unfortunately, the crucial role that the manufacturing sector must play if full employment conditions are to be established in Canada is often overlooked. A particularly deceptive argument in this context is the view that Canada's economy can prosper on the basis of growth in "service sector" job-creation independently of manufacturing sector job-creation. This view reflects a superficial understanding of our economy. A large part of the service sector is intricately linked to the production of goods. A large part of the growth of service sector jobs is related to the production of goods rather than to the provision of services for final consumption.

Manufacturing employment today amounts to about two million. This figure, however, ignores the indirect employment-creating role of manufacturing. The manufacturing sector is the most important generator of indirect jobs -- according to Statistics Canada, more than two jobs are created indirectly for every direct job created. This illustrates that manufacturing in a real sense stands at the centre of the economic process. When manufacturing activity expands, demand is created backward in terms of primary sectors supplying materials, and forward in that income generated in the goods sector is the most important basis for consumer demand for the output of the services sector.

In addition to the impact on jobs, the manufacturing sector's other major impact on Canada's economic life is in the area of trade. Manufactured products accounted for 67 per cent of Canadian merchandise exports and almost 83 per cent of merchandise imports in 1976. In 1977, the trade deficit in end products amounted to about \$11 billion, or more than five per cent of Canada's GNP.

The manufacturing trade picture is particularly important from the point of view of jobs and the goal of full employment. Even if Canada's deficit in manufactured goods was covered by a corresponding surplus in, say, resource products, this would not produce the jobs needed in Canada. Trade balances are calculated in money terms; but it is crucial to think of them in job terms as well. A situation like the one described -- a manufactured products deficit covered by a resource products surplus in dollar terms -- actually involves a job deficit. This follows from the more labour-intensive nature of the manufacturing sector relative to other sectors. It has been estimated by one of the provinces that the deficit in end products represents a potential employment opportunity of 170,000 direct jobs.

Finally, the manufacturing sector has a crucial role to play in alleviating the pattern of regional disparities in Canada. This results directly from its superior role as a generator of both jobs and income. At the present time, the mix of manufacturing activity differs considerably from region to region, with the west and the Atlantic regions specializing in resource-related processing, Ontario in durable

goods and Quebec in non-durable goods. A useful way of looking at the regional dimension is to compare the distribution of population and the distribution of manufacturing activity. The two extreme cases in this context are the Atlantic region and Ontario. In 1975, the Atlantic provinces had 10 per cent of the Canadian population but accounted for only 4 per cent of value added in Canadian manufacturing. Ontario, on the other hand, had 36 per cent of the population, but 51 per cent of national value added in manufacturing. It is hardly coincidental that these two regions also represent the extremes of regional disparities in Canada measured in terms of basic standards of living, as measured by personal income per capita. The argument that emerges, then, is that significant regional industrialization should focus on manufacturing.

The Economic Environment Required for A Strong Manufacturing Sector

Central to improving the competitiveness and productivity of Canadian business is an economic policy that places a high priority on economic growth. Business and labour agree that governments must continually demonstrate, and publicly express, this commitment. This is the prior condition for improving the competitiveness and productivity of Canadian manufacturing industries and is the single most important recommendation common to all sector Task force reports.

The recommendations are aimed at improving industrial efficiency, redirecting government funding to higher growth and job-creating activities, and increasing support to industries involved in exporting or replacing imports. We acknowledge that if all the tax recommendations in the Task force reports were implemented at the same time, there would be such a massive reduction of government revenues that the results would be unacceptable. Governments will, therefore, need to assign priorities to recommendations that are consistent with lower inflation and real economic growth.

Another area affecting the economic environment, which was a common concern to business members of the Task forces, was government regulation. The Committee agrees that government regulation is necessary in a modern democratic economy especially to protect the rights of individuals or groups who otherwise could not protect themselves. The Committee did not deal with government regulation as a specific issue because of the

massive study currently being conducted in this area by the Economic Council -- a study initiated by First Ministers at the same meeting that this report was requested. We believe, however, that government regulation should be simplified, and that conflicts and overlaps among and within governments should be resolved in order to reduce the cost to industry and government of enforcing and meeting regulation. An area of particular concern to business members of the Task forces was that government should make available cost-benefit analyses of any new regulations prior to their introduction into law. The labour concern was that cost-benefit analyses do not express the true value of social benefits. The Committee, therefore, recommends that impact assessments take into full consideration both qualitative and quantitative aspects.

The Tier II Committee in advocating a strong economic growth policy does so in the belief that the Canadian economy contains many substantial underlying strengths to support this policy. These strengths include a well-trained and highly skilled labour force, competent managers and technologists, strong and aggressive entrepreneurs, a strong and progressive trade union movement, sophisticated transportation and communication systems, a large natural resource endowment, and internationally competitive financial, banking and trade services.

In sum, the pursuit of stimulative economic policies by government when combined with the recommendations of the Tier II Committee would create jobs for Canadians throughout Canada, increase production, favourably influence Canada's balance of payments and provide the impetus for strong, sustained and significant real growth in Canada's national production and income.

As a result, we believe the principles basic to improving the competitiveness and productivity of Canadian manufacturing industries must be:

- To stimulate economic growth and job creation as one of Canada's first priorities;
- To foster an environment of understanding in which more effective consultation can take place among labour, business and government;
- To recognize the vital importance that manufacturing industries have in enhancing the living standards of individual Canadians.

It is on the basis of such a perspective that the Tier II Committee has highlighted nine major areas affecting all manufacturing industries where specific actions are recommended. These issues and recommendations are only the first step. They illustrate that significant areas of agreement exist between labour and business and that a basis has been established for further dialogue to be pursued in the mutual interests of all the participants.

Governments, through the federal Minister of Industry, Trade and Commerce, facilitated this process. Their continued involvement is important and their commitment to effective and continuing dialogue with business and labour will be measured by the manner in which they consider and act upon these reports.

PART II THE ISSUES

The charter of the Second Tier Committee has been to draw common concerns and solutions from sector Task force reports.

We must first commend the efforts of the 23 sector Task forces. Their reports make both general economic and sector-specific recommendations. We have made only a limited attempt to identify sector-specific issues in this report.

We have concentrated on those nine issues most commonly identified by all sectors. In some cases, we have presented recommendations drawn directly from the reports -- in others, we have attempted to "sense" the directions recommended and have presented what we felt to be a synthesis of these recommendations.

We have identified, in some cases, areas where agreement by business and labour could not be reached -- but we are optimistic about much more agreement being reached, given more time. We have, therefore, recommended that labour and business work on these issues together in the future, with a view to making joint recommendations to government where possible.

Trade and Multilateral Trade Negotiations

The importance of trade to manufacturing industries, and in turn the importance of manufacturing trade to the economy as a whole, is clear from the basic statistics. In 1976, manufactured product exports (\$25.4 billion) accounted for two-thirds of all Canadian merchandise exports, while manufactured imports (\$30.6 billion) accounted for four-fifths of all merchandise imports.

The present time is one of particular uncertainty on the trade front as the "Tokyo Round" of the GATT is being completed. This agreement will set the scene for trade relations for at least the decade of the 80s and perhaps until the close of the century. A key general concern of the Task forces -- and one which this Committee strongly shares -- is that Canada negotiate reciprocity in the GATT; or, to put it bluntly, that it receives as much as it gives. This Committee also is concerned that specific industries that are vital in a political and economic sense, and which cannot be in a position to compete internationally in the foreseeable future, should be protected as they are in other developed countries. Nevertheless, the Committee recognizes that any exemptions from tariff reductions under the GATT may have to be compensated for by concessions in other areas which are on stronger ground in terms of competitive ability.

Incentives must be created in response to the new trading environment created by the GATT. Such incentives are necessary for maximizing export opportunities created by the GATT. In addition, the Canadian domestic market must not be sacrificed to the practices of foreign countries that are contrary to the spirit or the letter of the new trade agreement.

In light of these general considerations, this Committee recommends:

1. That encouragement should be given to the formation of consortia to capitalize on export opportunities. This would be particularly advantageous in relation to design, supply and construction related to large-scale development projects. Particular support is required in removing legal impediments and developing instruments to cope with extraordinary risk factors in large foreign contracts. Such instruments should include competitive financing and insurance.
2. That Canada rely on the multilateral trade agreement route in its general trade policy; continental free

trade should not be pursued as a general policy, but only as a selective sectoral strategy where appropriate.

3. That in the current round of Geneva trade negotiations, the Canadian negotiators should push for a phasing of the lowered trade barriers that allows the greatest ease of transition for affected industries. The Committee specifically recommends an eight to 10-year phase-in period but with a provision for suspension of the implementation of trade barrier reductions for industries encountering particularly difficult problems of adjustment. Canada must not undertake on its own initiative -- as was the case in the Kennedy Round -- a rate of implementation faster than necessary under the Tokyo Round.
4. There are certain manufacturing industries that are vital and where any degree of reduction in protection would be disastrous at this time. The Committee recommends that these industries be completely exempted from the Tokyo Round. The key case in point is the clothing and textiles sector which employs close to 200,000 workers.
5. That the federal government develop a comprehensive adjustment assistance program that is based on an assessment of needs, industry by industry, in consultation with labour and business. It should be directed both at industries that need assistance to capitalize on the opportunities provided by the GATT and at industries whose viability has been undermined in the trade negotiations.
6. In the current set of trade negotiations, Canada should press for the maximum degree of multilateral reduction of non-trade barriers. However, to the extent that other countries subsequently circumvent any agreement along these lines, Canada must use non-tariff barriers on a competitive basis in order to protect Canadian production and jobs.
7. That the federal government set up a formal procedure for monitoring unfair trade practices, including the creation of non-tariff barriers which may nullify any reduction in tariff barriers coming out of the Tokyo Round.
8. That appropriate mechanisms be found to simplify and reduce the cost of, and improve the speed and

efficiency of, the safeguard processes which deal with trade-related matters such as injury determination, monitoring of non-tariff barriers and unfair trade practices, the determination of safeguard action, and tariff references.

Manpower and Labour Relations

MANPOWER

Manpower policy should be, in the view of the Committee, a full employment policy. It should be a policy that endeavours not only to ensure industry with a labour force necessary to meet its needs but also aims at providing the individual Canadian worker with the opportunities to improve his or her level of skill, encourages mobility, and enables the individual to have a more fulfilling and satisfying work experience.

Sector Task force reports deal with manpower planning and forecasting, the training and development of manpower and manpower mobility within Canada.

Widespread concern was expressed in several Task force reports that skilled trades shortages are a serious problem that requires urgent national attention.

Among the measures required is a mechanism for maintaining an inventory of possible manpower needs as well as for ensuring that appropriate training and educational programs are in place. Second, while training is one method of ensuring manpower resources, mobility provides another means of meeting these needs. Manpower mobility in the Canadian context, however, often is impeded not only by great geographic distances but by differing regional traditions and values. The Committee believes that training and mobility programs should not be used to give the impression of creating jobs; they must be complementary to industrial activity.

Fundamental differences in approach exist between labour and business with respect to the unemployment insurance system. However, both agree that payments involving more than \$4 billion a year are simply too high and that job creation on a more effective basis is an immediate necessity.

The Committee, therefore, recommends that:

1. In those industries where manpower resources, training and planning are inadequate, industry and labour should meet regularly to forecast needs and recommend training and education programs to governments, sector by sector.

For an overall picture, an autonomous body, jointly supported by provincial and federal governments and by business and labour, should be created to integrate sector inventories of manpower availability and needs and to advise on manpower policy, training and educational requirements. This body would make reports assessing the medium and long-term manpower requirements.

2. Existing manpower funding should be significantly redirected to support job-oriented training. That is, much less emphasis should be placed on institutional training which involves little or no relationship to job opportunities. Such a shift in manpower programs would:

- result in a significant increase in "on-the-job" training and other programs related to identifiable jobs in the marketplace. Such training should take account of the need to adjust wages and training allowances in a manner that would encourage candidates to participate in such training. Firms also would be encouraged to participate more fully in such programs.
- be consistent with the recommendation of the Aerospace Task Force that a payroll levy be considered for those sectors that see a need for this approach and support its implementation. The purpose of this levy would be to spread the costs of this training among firms.

3. While mobility programs are not alternatives to job creation in Canada, every effort should be made by governments to reduce impediments to individuals willing to move. For example, provincial actions or restrictions that reduce manpower mobility should be abolished. In addition:

- governments should establish or review mobility programs with the objective of ensuring that either through grants or tax concessions, unemployed individuals willing to move for full-time employment, but unable to do so because of the personal financial costs involved, will be subsidized to offset those costs.
- programs to assist individuals investigating job opportunities should include provision for spouses to accompany them.

LABOUR RELATIONS

The Canadian labour relations system, in the view of the Task forces and the Committee, has developed in a manner which, for the most part, operate well. The vast majority of labour contracts are settled without work stoppages. Improvements are, nonetheless, necessary. Where change seems desirable, Canadian solutions should be found for Canadian problems and governments should not attempt to import foreign systems.

The following principles are basic to the Canadian system:

- a) the right of unions to exist in Canada,
- b) the freedom of association of workers as a basic democratic right, and
- c) the right to bargain collectively.

Labour and business should enter into much more intensive and active dialogue at all levels to seek out areas where agreement exists or may be possible and, in areas where disagreements exist, to provide a better basis of understanding.

The members of the Committee agree that labour and business will establish a private sector committee to study labour relations in Canada and report to First Ministers. The following issues, as a minimum, most of which were raised by the Task forces, shall be studied:

- Standardization of labour codes and practices
- Certification
- Role, functions and structure of labour relations boards
- The resolution of impasses in negotiations, including impasses on first agreements
- Differential treatment of public service employees
- Union security
- Safety and health
- Picketing code
- Minimum wages

- The rights of parties during strikes
- Grievance, arbitration and rights disputes
- Government-supervised secret ballot strike vote
- The right to strike in essential services
- Unlawful strikes and lockouts
- Unfair labour practices

Where governments believe action is required before the report of this Committee is complete, they have a responsibility to consult with business and labour before taking action.

Taxation

The general thrust of Task force reports is that the total economic environment is of vital importance to manufacturing. Taxation is an important ingredient in this environment.

The Task force reports made recommendations at virtually all levels of the tax system -- personal income, corporate income, sales and wealth (specifically property and capital gains). The key underlying issue expressed by the Task forces is the tax system's role in creating an environment that supports incentives, particularly the incentive to invest and the opportunity for individual economic progress. The incentive concern of the taxation discussion relates primarily to the role of taxation in economic growth and efficiency.

Clearly, the maximization of growth and efficiency is one key role for the taxation system, in order to rebuild the manufacturing sector. Another key function is in the context of social goals (i.e., the taxation system has an important role to play in the redistribution of wealth as distinct from the creation of wealth).

The Committee makes the following recommendations:

1. Changes in corporate taxation should be evaluated in the context of all the factors that determine international competitiveness. The differential

treatment of corporations from country to country -- whether in terms of the direct tax rate, or in terms of tax concessions such as accelerated write-offs, tax-credits, etc. -- are as crucial as other cost items, including wages, transportation, and tariffs, and should be considered in that light.

2. A greater degree of co-ordination of fiscal policy should exist among levels of government to meet national goals. The need for more intensive consultation will become greater as provinces increasingly develop their own taxation systems (e.g., the personal tax rate structure as now exists in Quebec).
3. Some Task forces observed that there are inconsistencies in the corporate tax rate and tax concessions from industry to industry (e.g., logging and forest products). Such inconsistencies should be reviewed and their continuation be dependent on a more clearly established rationale.
4. Some Task forces recommended sales tax cuts or the extension of current exemptions on products such as footwear and clothing. The Committee recommends consideration of this approach, both as a stimulus to demand for particular products and as relief to low-income groups for whom these items represent a particularly large proportion of expenditure.

The Committee is concerned, however, that in certain sectors a large part of the stimulative impact would be lost to imports. In such sectors, the Committee recommends that other stimulative measures be considered.

5. The Committee concurs with the recommendations of several Task forces that sales taxes on construction materials and equipment be removed.
6. A number of Task forces made specific recommendations on the problem of the preferential treatment provided by the federal sales tax to imported products compared with domestically manufactured products. The Committee is aware that this issue is under intensive study, and there is still inadequate information on the impact of various potential solutions. Accordingly, the Committee is unable to categorically recommend appropriate modifications, but it urges that the current recognized discrimination against Canadian manufactured products be removed as soon as possible.

7. The Committee notes that the deductibility of mortgage interest payments should be reviewed; such a review should give careful consideration to delivering the greatest benefits to the lowest income groups.
8. The Committee recommends that an in-depth study be made on the feasibility of implementing value-added based taxes in place of existing taxes.

There were several other specific recommendations within the taxation system that were considered by the Committee but which did not result in a common position by business and labour participants. We summarize briefly below the respective positions on a few of the more important ones:

- Several Task forces recommended the adoption of "inflation accounting" for corporations. The business members of this Committee favoured such an approach on the grounds that in an inflationary period, profits and thus taxes are artificially inflated, particularly in that the replacement costs of machinery and inventory are insufficiently "accounted" for. For example, a number of Task forces recommended that business be given the option of using the existing three per cent inventory tax allowance or the LIFO system of inventory valuation.

Labour members argued that during an inflationary period there were forces at work in both directions -- exaggerating profits and reducing profits (e.g., lowered real costs of corporate borrowing) -- and that current profit increases far exceed the present inflation rate while real wages are declining.

- Some Task force reports contained the recommendation for elimination or liberalization of the capital gains tax. The business members of this Committee concurred because the tax has had a negative effect on the incentive to invest, and because the administrative costs were too high relative to the revenue produced.

The labour members felt that the existing capital gains tax should be expanded by taxing the full gain rather than only one-half of the gain, on the basic philosophy that all income however accumulated should be taxed.

- There is a distinct divergence in the attitude toward tax changes that have occurred in recent years. The

business group felt that a number of changes such as the two-year write-off and the lower tax rate of manufacturing and processing were very beneficial steps and commended the government for them.

On the other hand, Labour is concerned that many changes in the taxation system have been made in recent years on an ad hoc basis without a clear rationale in terms of their impact on the overall role of the tax system in an efficiency-equity context. Moreover, it believes that changes in the tax system should be subjected to a review that answers the question: what impact does the change have on the total tax system and, in particular, what does it do to the equity-efficiency principle. Labour suggested that this review might be conducted by an appropriate parliamentary committee.

- The Committee discussed at some length the current level of corporate taxation in the manufacturing sector.

The business representatives on the Committee felt that there was a strong case for encouraging investment through reductions in either the nominal tax rate or in the effective rate through expansion of tax concessions such as the investment tax credit. This was the view of business in the sectoral Task forces.

The labour representatives argued that there was no case for such reductions: recent investment performance was attributable to under utilization of existing capacity rather than low profitability. However, labour and business do agree that such incentives be used for investment in Canada to create jobs and increase productivity that would not otherwise occur.

If all the tax recommendations in the Task force reports were implemented, a massive reduction in government revenues would follow. Therefore, priority must first be given to those proposals that most directly improve the competitive strength of Canadian manufacturing and generate growth in the economy and create new jobs. Substantial new revenues will flow from the growth of manufacturing that will result from the changes.

Research and Development

A majority of the sector Task forces expressed a concern about the low level of national resources devoted to research and development activity. This concern is shared by

both the business and labour participants on this Committee. The Committee considers that increased domestic effort in the R & D area is a crucial ingredient to expansion of the Canadian manufacturing sector, not only on the part of "leading edge" and high technology industries but also in Canada's more mature industries which must maintain or regain their cost and product competitiveness. Most basic research and development is done elsewhere (largely in the home country of multinational -- or North American -- companies) and once a product is tested and refined elsewhere, it has traditionally been adopted in Canada.

Canada should aim at self-sufficiency in technology; that is, to balance exports against imports of technology. This requires an economic environment encouraging the growth of the domestic market, the development of incentives to attract R & D activities of an international scale, and policies that differentiate between support for large corporations and small firms. Furthermore, the unique structure of Canadian industry has particular implications for technological development in Canada requiring special consideration.

For example, a large opportunity exists to increase the research activity of domestic and foreign-controlled multinational corporations in Canada.

A particular concern expressed by the members of this Committee is that government support to R & D activity be available on a sufficiently long-run and predictable basis that it encourages new and sustained activity. More specifically, R & D support should be available for both the initial start-up of R & D activity as well as for the continuing R & D activity that is necessary to maintain the relevance of that original effort.

A further concern expressed by this Committee is that, in some cases, the benefits from R & D activity, undertaken in Canada at public expense, are transferred outside the country without overall net benefit to Canada, such as when Canadian operations move or expand to other countries.

Both the labour and business participants agree that public incentives should be directed to inducing new R & D activity to the greatest extent possible in the private sector.

The objective of the incentive programs recommended herein is to increase significantly the overall level of R & D activity in Canada. They must not result in just a continuation of existing (or even reduced) levels of activity with a transfer of the funding from the private to the public sector. Some form of "pay back" mechanism could be considered in appropriate cases.

The Committee notes the acceptance by government of a goal of 1.5 per cent of GNP for R & D expenditures. The achievement of this goal will require a dramatic change in the climate for R & D activity.

In light of these general problems and issues, the following recommendations are made:

1. While the Committee does not want to set down a specific goal (e.g., a certain percentage of GNP), there should be a significant increase in the level and percentage of national resources devoted to R & D.
2. The increase in the share of national resources devoted to R & D will require more, not less, government support at all levels. The thrust of increased government support of R & D should, the Committee recommends, be in the direction of indirect activity (i.e., the provision of tax/grant support) rather than direct government R & D activity.
3. Direct government R & D activity should emphasize basic research. Developmental R & D done by government should be undertaken on the basis of consultation with the private sector and in view of specific market opportunities.
4. Governmental assistance to R & D should be in the form of a package of available measures (i.e., tax measures in the form of write-offs and/or tax credits, or direct shared-cost grant programs) that can be applied flexibly depending on the characteristics of individual projects.
5. Since direct funding does reduce the risk shouldered by the entrepreneur, some "pay back" mechanism is appropriate in those instances where the research has led to a successfully commercialized and profitable venture.
6. The Committee recommends that a special effort be made to assure a higher Canadian share of the R & D activity of foreign-based companies. Consideration should be given to the design of programs to achieve this end. R & D benefits to Canada should be given more emphasis as an explicit evaluation criterion used by the Foreign Investment Review Agency.

7. The definition of "R & D" from program to program at one level of government, and from government level to government level, should be standardized. The Committee specifically recommends the definition used in the federal IRDIA program.
8. Government assistance to R & D should be available over a sufficient period of time -- say 10 years -- in order to induce a long-run commitment to R & D activity on the part of the private sector.
9. Safeguards should prevent the transfer outside the country, without compensation, of R & D benefits financed at public expense.

Energy

A common concern throughout the Task force reports was the question of energy. The availability and cost of energy are key elements in the competitiveness of the primary and secondary industries in Canada. Energy costs are reflected in both the production and the transportation of goods. The cost of energy bears on the disposable income of all Canadians.

The largest and currently most economical sources of energy in Canada are fossil fuels (oil, gas and coal), water resources (hydro-electric power) and uranium. Oil, gas and coal are used in the energy form of heat (heating industrial, commercial and home buildings), in the generation of electric power, in the processing of goods and in transportation. Water resources and uranium are used in the form of electricity (to drive industrial machinery, to control equipment and for heating and lighting). In addition, oil and gas are used in the production of a wide and economically important range of chemicals, plastics and textiles.

There is considerable concern that the energy policy for Canada is inadequately developed relative to regional natural advantages and from the point of view of balance among sources. Although some progress has been made by federal and provincial governments, especially relative to other countries, there does not appear to be an adequate set of coherent policies leading to an overall strategy which would result in the optimum use of available energy resources. This Committee recognizes the difficulty of the federal and provincial governments achieving this goal. However, without a more focussed policy, it is believed that the energy-related deficit of international payments will, in future, be higher than is necessary and that action should be taken now to control this potential problem.

We welcome the initiative of the federal government, in co-operation with the provinces, in the development of a national coal policy with the objective of delineating current coal reserves and encouraging research programs on the conversion of coal to synthetic products. Considerations should include gasification, transportation and an export policy that will positively ensure adequate domestic supplies in the long term.

It is important that price levels for energy in Canada be competitive with those levels in the United States where goods are produced that compete with products made in Canada. It is believed that insufficient consideration is being given to Canadian price levels in relation to the appropriate U.S. pricing structure. The price (cost) of fossil fuels in Canada has a very important impact on the cost of chemicals, plastics and textiles which in turn is reflected in the cost of consumer goods.

It is also thought that there is potential for greater upgrading of energy sources before they are exported. For example, the Alberta government has shown interest in the production and increased exports of petrochemicals rather than just the export of natural gas.

In light of these considerations, the Committee recommends:

1. A national energy policy should be developed by federal-provincial governments in consultation with interested parties. The objectives of such a policy should be:
 - to ensure that Canada retains energy self-sufficiency in the long term;
 - to develop energy exports in a manner which will positively ensure that Canada will not run out of appropriate energy sources in the future.
 - to co-ordinate energy development plans and future use in Canada.

The Committee recognizes that such a policy effort might, in some instance, infringe on traditional rights enjoyed by the private sector prior to the energy crisis. The Committee recommends such intrusions be kept at a minimum consistent with the national interest and public good.

This policy should take into account the welfare of the nation in the long term, and should recognize that energy is one of the keys to Canada's survival as a trading nation, its future self-sufficiency, and is the basis for the future health and growth of its industries.

2. A timetable should be established to bring these resources on stream in a way that would create an orderly flow of capital and extend the life of our non-renewable resources.
3. Pricing and taxation policies be so structured that adequate energy sources will be developed.
4. The conservation of energy is an integral part of such policy and it is emphasized that there is potential for the more efficient use of waste products. For example, in the forest industry, current environmental constraints in this area should be re-examined. The program to establish energy conservation goals would also be enhanced by co-ordination between energy suppliers and users.
5. Where possible energy should be developed and sold in the form that represents the optimum amount of upgrading.
6. The pricing policy for energy should ensure that Canadian secondary producers are not put at a cost disadvantage relative to their international competitors, particularly those in the United States. Therefore, serious consideration must be given to the appropriate U.S. pricing structure in establishing the pricing policy in Canada. At the same time, prices in Canada must change at a rate that does not exceed the capacity of the user industries to adjust.

It is also pointed out that without an appropriate link to U.S. prices, certain industries, such as the fertilizer industry, will have no incentive to expand.

Transportation Costs

The geographic size and population dispersion of Canada means that transportation costs are a more important factor in maintaining a competitive industrial structure than in many other countries. Indeed, for manufacturing industries, transportation costs can range up to 50 per cent of the final cost of the finished goods or materials. They are higher in many cases than in the United States, our main market. The Committee recognizes that the area of transportation policy must be concerned with the development of an efficient and effective transportation infrastructure and network throughout Canada. The transportation field is simply too complex and far-reaching for the Committee to fully consider within the time available. However, the many adverse transportation factors affecting the Canadian manufacturing sector must be resolved.

The Committee accepts that subsidies may well be required to move some types of goods to markets, to or from some regions of Canada, both to facilitate the movement of goods in Canada and to strengthen Canadian regions. However, the Committee also recommends that these trade-offs, of social equity versus efficiency, be re-examined in the light of Canadian conditions in 1978. For example, should one class of goods be required by the carrier to subsidize the transport of another class, or should such subsidies be paid directly by governments?

The rate-setting system for all modes of transportation was of particular concern to many Task forces. In those cases where the rate structure is administered (i.e., regulated), rather than determined by the free play of the market, under truly competitive conditions, Committee members and some individual Task forces emphasized the lack of recognized formal appeal mechanisms, the absence of adequate prior consultation and, where appeals are possible, the often time-consuming and expensive process involved.

Regional Development

Broad agreement is expressed by the Task forces that regional economic development is fundamental to the concept of equitable sharing among Canadians of the country's resources. Indeed, this is the very essence of federalism. This development should encourage economic growth and job creation through attracting new industries to the less-developed regions. It is accepted that incentives should be used to influence the investment decisions of industries that are considering new or growth opportunities.

The Committee agrees that grants to provinces, loans and tax incentives all are important mechanisms for achieving regional economic development objectives. In general, grants to provinces are viewed as appropriate in establishing an adequate infrastructure.

The Committee is concerned that programs for regional development should not result in the fragmentation of existing industries and believes that lack of consultation with business and labour may have created some unnecessary overcapacity.

It is recommended, therefore, that:

1. Provincial governments publish on a regular basis their priorities and compare their plans at federal-provincial meetings in an attempt to reach consensus and harmonization.
2. To the extent possible, on proposed major government-assisted industrial projects, there be consultation with business and labour prior to grants being made with a view to minimizing national fragmentation or overcapacity in any industry.
3. The primary reliance on the grant system as an incentive mechanism for industries to locate in the less-developed regions of the country be reconsidered and that loan or tax instruments be made available as appropriate. Where grants are made, they should be paid out over an appropriate period of time to encourage sustained operations.
4. The criteria for making incentives available to industry to locate regionally include:
 - a) that they focus on import substitution as a means of developing a domestic market without damaging existing producers,
 - b) the recognition that protecting existing jobs is as important as creating new jobs; therefore, modernization of a plant should be as eligible for assistance, and at the same level, as the building of a new plant.
 - c) adoption of the approach that programs encourage industries that are "complementary to" rather than "in competition with" existing industry.

Government Purchasing Policies

Many Task forces expressed concern that federal and provincial governments are not using purchasing policies and practices in support of optimum industrial development in Canada. The governments of many foreign countries openly or subtly use purchasing power very effectively as a tool of industrial strategy. It is believed that provincial and federal governments do not recognize that Canadian suppliers are competing in domestic and export markets with foreign companies whose competitive strength derives, to a significant extent, from the purchasing policies of their home governments. The major issue is the extent to which governments in Canada can and should use federal and provincial purchasing power to equivalent purpose.

Canada's objective at the GATT should be the elimination of as many non-tariff barriers (NTBs) as can possibly be negotiated. Where NTBs cannot be eliminated, Canada should adopt them reciprocally.

Domestically, much greater uniformity could be sought among governments in the setting of designs, specifications and standards and these could be reflected in commercial practice.

There is concern as well that certain provincial government purchasing policies are designed primarily to encourage regional development. An effect of this policy that may not be appreciated is the resulting fragmentation of industries which reduces their cost competitiveness in both the domestic and export markets.

In areas of the market open to international competition, governments are not responding to the fact that Canada's geopolitical structure places this country's industries at a disadvantage vis-à-vis our international competitors from countries that have "national interest" purchasing policies. For instance, some public utilities and other state-owned enterprises in many foreign countries purchase primarily from their domestic sources. In such countries this policy is designed to provide employment and investment and to support export development. Canadian companies must compete with the impact of this policy both in the Canadian market and in the export market. Thousands of jobs are involved. Some municipalities do not fully appreciate the negative economic and social impact in Canada of purchasing goods from foreign sources.

It is recommended, therefore, that:

1. Action be taken to standardize governments' design and specifications of as many products as possible. Such standardization should relate to the commercial market. The result will be economies of scale for Canadian industry such that unit costs are reduced, the public will benefit from the lower costs, and Canadian industries will be more competitive in the domestic and export markets. As sales increase there will be more investment and increased employment.
2. The purchasing policies and practices of the various levels of governments should be more directly related to promoting industrial development in Canada, by taking into account:
 - a) the tangible economic benefits to Canada of sourcing in Canada;
 - b) the potential for offset arrangements where goods are sourced outside of Canada;
 - c) the impact of their purchasing policies on rationalization and fragmentation of Canadian industries; and
 - d) the extent to which their purchasing policies are consistent with the overall industrial development of Canada.
3. Governments recognize and take into consideration the realities of the trading practices of many foreign countries in the use of government purchasing power to enhance industrial development and should assure that purchasing practices in Canada are consistent with those of the countries with which Canadians have to compete at home and abroad. This includes recognition of the impact on Canada of trading practices, which are not legitimate under the GATT, including the dumping of foreign goods.

Appropriate purchasing policies by governments, including procedures, will reduce the incidence of dumping and that in turn will increase employment in Canada by potentially thousands of jobs.

Rationalization

While the individual Task forces did not discuss rationalization as an explicit issue in a majority of cases, this Committee has identified it as a distinct and fundamental issue. Rationalization is potentially one of the most important factors in improving the competitiveness and productivity of Canadian manufacturing industries. Even where not discussed explicitly, rationalization was an implicit part of the discussion of other issues (e.g., trade, competition legislation and regional development).

The need for greater rationalization of Canadian manufacturing is recognized by the Committee as the basis of both profit and wage gains. Plant size and size of product runs are low by international standards. While there is room for argument about just how large Canadian operations must be to become more competitive, to increase exports and replace imports, it is agreed that, in general, greater rationalization of Canadian firms in some areas is an important avenue for productivity gains.

Probably even more important than plant size in accounting for Canada's relatively low productivity in some areas of manufacturing (lower at least than in the United States, our key trading partner) is the phenomenon of multi-products runs. Whatever the overall plant scale, Canadian operations are too often characterized by production of several products geared to the small domestic market. This creates inefficiencies in both the use of labour and capital (e.g., machine down time).

A third issue identified by the Committee is the advisability of "joint efforts" by otherwise independent producers, particularly in the area of exports.

The Committee recognizes that the rationalization process inflicts hardships on individuals (e.g., older workers who are not retrainable) and on whole communities (e.g., single plant communities that are affected by the centralization of operations). The Committee recognizes, then, that the gains of the rationalization process must be shared with those who are harmed by the process.

In light of these considerations, the Committee recommends:

1. Domestic and international rationalization should be encouraged consistent with criteria such as job creation and skill development, industrial efficiency, increased domestic research and development, a more favourable balance of payments, and increased Canadian ownership.
2. The federal and provincial governments should encourage the setting up of joint service facilities for operations that cannot justify such facilities on their own. Particular examples are joint private training programs and computer facilities.
3. Competition legislation should be written in a way that encourages the rationalization process with provisions for appropriate checks and balances against the abuse of power contrary to the public interest.
4. In the case of communities that would be adversely affected by plant shut-downs as a result of rationalization, there should be a community adjustment plan implemented which would include provisions for the application of existing programs (such as training and job-creation) as well as the bridging mechanisms that may not be part of existing ongoing programs (e.g., special pension provisions for those under the normal retirement age).
5. The federal government should compile and publicize past rationalization cases in order to illustrate the potential benefits of rationalization.

PART III CONTINUING CONSULTATION

The members of the Tier II Committee regard the reports of the Task forces and this report, and the process by which they have been produced, as an important benchmark in the formation of public policy which involved provincial and federal governments. Business and labour also came together because of a deep concern for the economic problems facing this country. It is to be hoped that a continuation of this dialogue between business and labour can further improve understanding.

An important result of this process has been the realization that when business and labour focus on specific problems or actions, wide areas of agreement can be found. In our view this provides a useful indication for any future activities of this kind; namely, that progress is more likely in cases where attempts are made to come to grips with industry sector-related or specific problems rather than with those aimed only at establishing broad principles or goals.

The Committee and the Task forces were concerned that the very limited time frame imposed upon them necessitated less than thoroughly developed and documented reports. It is unrealistic for business and labour to resolve the complex issues dealing with manufacturing in Canada in a three-month period. Industrial policy has been researched for many years and is marked by a diversity of opinion not only between industrial countries but within Canada. When viewed in this context, this report represents a significant "first time" agreement between business and labour on broad issues affecting industry.

The mandate given to the Second Tier Committee will be completed with the consideration of this report by First Ministers. However, many of the Task forces and this Committee believe that the consultative process for addressing economic issues facing this country must be continued in some form. The Committee therefore recommends that:

- 1) Governments accept the obligation to inform the sector Task forces and the Second Tier Committee about the actions taken in response to recommendations made.
- 2) First Ministers consider reports from the Labour Relations Committee that will be established by business and labour.

- 3) The consultative process at the sector level and at the cross-sectoral level continue to take place. This will require the Second Tier Committee or its successor to devise, in consultation with the sectors and with governments, appropriate mechanisms.

PART IV CONCLUSION

In this report, we have stressed job creation as a priority and we have proposed measures to improve our technology and increase our productivity, emphasizing increased research and development, an expanded energy policy and further rationalization.

We have proposed further study in the area of manpower and labour relations.

We have identified the importance of creating confidence in the general environment -- especially through the two key functions of taxation.

We have recommended measures which will help alleviate regional disparities in Canada.

Finally, we have proposed measures to protect our market and our people, on a reciprocal basis with other countries. We have asked governments to support this with procurement policies.

The Committee also believes that expansion will result in rising productivity and that this, in the long run, is one major answer to the problem of inflation and our other economic difficulties.

Our recommendations are designed to create an atmosphere of confidence in manufacturing. This confidence should result in growth and jobs. The Committee's opinion is that Canada has underlying strengths which, when combined with recommended measures, will bring about expansion and prosperity.

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